

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
)
 MAUNA LANI STP, INC. and)
 HAWAII-AMERICAN WATER COMPANY)
)
 For Approval of the Sale and Transfer)
 of Assets of Mauna Lani STP, Inc. and)
 Related Matters.)
 _____)

DOCKET NO. 05-0229

DECISION AND ORDER NO. 22299

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Karen Higashi
Chief Clerk of the Commission

ATTEST: A True Copy
KAREN HIGASHI
Chief Clerk, Public Utilities
Commission, State of Hawaii.

K. Higashi

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By this Decision and Order, the commission approves the sale and transfer of MAUNA LANI STP, INC.'s ("Mauna Lani STP") utility assets, operations, and certificate of public convenience and necessity ("CPCN") to HAWAII-AMERICAN WATER COMPANY ("HAWC"), subject to certain conditions as discussed herein.

Mauna Lani STP

¹Mauna Lani STP and HAWC are collectively referred to as the "Applicants".

the island of Hawaii.² Mauna Lani STP is a wholly-owned subsidiary of Tokyu Corporation, a Japan corporation.

Mauna Lani Resort (Operation), Inc. ("MLRO") is also an affiliate of Tokyu Corporation. MLRO owns and operates a brackish water system used to irrigate the common areas of MLRO's resort facilities and golf courses.³ Mauna Lani STP and MLRO, likewise, are affiliated entities.

Mauna Lani STP currently provides wastewater utility service to "two hotels, two golf courses, a clubhouse restaurant, a beachclub restaurant, a racquet club and spa, four commercial buildings, a company retreat facility, approximately 330 condominium units with approximately 300 additional condominium units under construction, and approximately 55 residential units through five homeowner associations."⁴

Mauna Lani STP's existing sewage treatment plant is described as follows:

The [sewage treatment plant] is an aerated lagoon system designed for 750,000 gallons per day (gpd). Current average daily flows are approximately 250,000 gpd. The raw wastewater enters the plant through the headworks. The headworks consist of one continuously cleaned filter screen and a screening bypass channel.

The screened raw wastewater enters into Lagoon No. 1 for primary treatment and then into Lagoon No. 2 for secondary treatment. The secondary

²See In re Mauna Lani STP, Inc., Docket No. 7377, Decision and Order No. 7377, filed on December 29, 1982.

³See Applicants' response to CA-IR-8 (description of Excluded Assets used to deliver brackish water irrigation use).

⁴Joint Application, Exhibits A - H, Verification, and Certificate of Service, filed on September 9, 2005 (collectively, "Joint Application"), at 4 - 5.

effluent is chlorinated prior to being recycled as irrigation water at the resort's ornamental plant nursery. Due to evaporation from the lagoons, the plant nursery receives approximately 180,000 gpd of the 250,000 gpd that enters the [sewage treatment plant]. This corresponds to an irrigation application rate of 179 inch[es] per year.

The [sewage treatment plant] produces wastewater effluent that satisfies the R-2 classification for recycled water

. . . .

[Mauna Lani STP] irrigates approximately 40 acres of ornamental plants using the drip irrigation method. The irrigation application rate is approximately 6,750 gpd of R-2 effluent per acre

Applicants' Attachment CA-IR-1(b) (Part 1), at 3 - 4 (Engineering Report for Mauna Lani Sewage Treatment Plant, dated June 2005, at 3 - 4).

2.

HAWC

HAWC, a Nevada corporation, is a public utility authorized to provide wastewater collection, treatment, and disposal service to approximately 10,000 residences, condominiums, and commercial establishments in the Hawaii Kai service area on the island of Oahu.⁵ An organizational chart depicting HAWC's upstream entities is attached to Applicants' response to CA-IR-17 (Applicants' Attachment CA-IR-17).

⁵Joint Application, at 6.

HAWC's sole shareholder is American Water Works Company Inc., dba American Water, a Delaware corporation.⁶ Applicants represent that American Water "is the nation's largest provider of regulated water and wastewater services."⁷ HAWC operates as part of American Water's Western Region, which includes American Water's largest wastewater utility operations.

American Water's stock is held by Thames Water Aqua U.S. Holdings, Inc., which in turn is held by Thames Water Aqua Holdings GmbH ("RWE Thames Water"), a subsidiary of RWE Aktiengesellschaft ("RWE").⁸

RWE Thames Water provides water and wastewater services to approximately seventy (70) million customers in North and South America, Asia-Pacific, Europe, and the Mediterranean. In the United Kingdom, RWE Thames Water's affiliate is the leading provider of water and wastewater services. RWE is an international provider of electricity, gas, water, and wastewater utility services.

⁶HAWC was formerly known as East Honolulu Community Services, Inc. ("EHCSI"). In January 1998, the commission approved American Water's acquisition of all the issued and outstanding shares of EHCSI. See In re Maunalua Assoc., Inc., Docket No. 97-0339, Decision and Order No. 16175, filed on January 27, 1998. Thereafter, American Water re-named EHCSI as HAWC.

⁷Joint Application, at 6.

⁸In April 2002, the commission approved RWE Thames Water's purchase of American Water's stock. See In re Hawaii-Am. Water Co., Inc., Docket No. 02-0041, Decision and Order No. 19304, filed on April 17, 2002.

HAWC "is committed to growing its regulated operations in Hawaii via utility acquisitions and, for this reason, is seeking to acquire the assets of Mauna Lani STP."⁹

B.

Joint Application

By Joint Application filed on September 9, 2005, Applicants request the commission's approval of an Asset Purchase Agreement, dated June 7, 2005 (the "Agreement"), and of other related matters that will ultimately result in the sale and transfer of Mauna Lani STP's utility assets, operations, and CPCN to HAWC. (See Section I(B)(3), below.) Applicants make their request pursuant to Hawaii Revised Statutes ("HRS") §§ 269-17 and 269-19 and Hawaii Administrative Rules ("HAR") chapter 6-61, subchapters 6, 9, and 10.

1.

Asset Purchase Agreement

Pursuant to the terms of the Agreement, attached as Exhibit A to the Joint Application:

1. Mauna Lani STP agrees to sell, transfer, and convey all of its right, title, and interest in its wastewater utility assets and operations, including Mauna Lani STP's CPCN,

⁹Joint Application, at 7.

to HAWC, for the purchase price of \$3 million.¹⁰ The subject assets and operations are collectively identified as the "Transferred Assets" in Section 1.1 of the Agreement.¹¹

2. HAWC will assume the duties to provide wastewater service to Mauna Lani STP's customers.¹²

3. HAWC will provide wastewater service under the name of Hawaii-American Water Company, a separate operation from its existing operation in Hawaii Kai.

The Agreement and sale of the Transferred Assets to HAWC are subject to certain conditions, including the commission's approval.¹³ The closing of the subject transaction

¹⁰Agreement, Recitals A - D, and Sections 1.1 and 2.1. Certain assets, defined as the "Excluded Assets" in Section 1.2 of the Agreement, are excluded from the sale, and instead, will remain the exclusive property of Mauna Lani STP or its affiliate. Agreement, Section 1.2. See also Applicants' response to CA-IR-8 (description of the Excluded Assets used to deliver brackish water for irrigation use).

"Applicants note that the Excluded Assets are not used, useful or necessary for Mauna Lani STP's utility operations and are not included as part of Mauna Lani STP's established rate base or on its books. As such, Applicants contend that approval under HRS § 269-19 is not required for Mauna Lani STP and/or its affiliate to own or otherwise retain ownership of the Excluded Assets. However, to the extent the Commission determines that its approval is necessary for Mauna Lani STP and/or its affiliate to own or otherwise retain ownership of the Excluded Assets, then Applicants hereby request such approval." Joint Application, at 8 n.10.

¹¹See also Agreement, Schedules 1.1. Applicants note that, prior to closing, Mauna Lani STP will be acquiring additional assets that will be included as part of the Transferred Assets that will be sold to HAWC.

¹²Agreement, Section 1.3.

¹³Agreement, Recital C and Sections 4.2(b)(v), 5.2(c)(iv), 8.1, 9.1, and 10.1.

will occur on a mutually agreeable date following the commission's approval of the Joint Application.¹⁴

2.

Financing

HAWC intends to borrow the necessary monies to fund the \$3 million purchase price and related closing and transaction costs, estimated at \$100,000, as unsecured debt from American Water Capital Corp. ("AWCC"), an affiliated entity. Applicants explain that "AWCC is the primary internal funding vehicle for American Water's utility companies, and the transfer of acquisition funds is a standard internal movement of corporate funds."¹⁵

HAWC and AWCC will memorialize their financial arrangement in a Financial Services Agreement. A draft copy of the Financial Services Agreement is attached to the Joint Application as Exhibit D.

Pursuant to the financing arrangement between HAWC and AWCC:

1. The funding of the purchase price and related costs will be documented by HAWC's issuance of a Promissory Note in favor of AWCC, in the approximate amount of \$3.1 million. A draft copy of the Promissory Note is incorporated in the draft Financial Services Agreement.

¹⁴Agreement, Section 3.1.

¹⁵Joint Application, at 18.

2. Interest will be charged on the unpaid outstanding principal balance of the loan at a rate per annum equal to the rate paid and to be paid by AWCC to its lenders with respect to the amount borrowed by HAWC. Interest payments will be due and payable on the same business day on which AWCC is required to pay interest on the borrowing. HAWC's Interest Expense Worksheet is attached as Exhibit H to the Joint Application.¹⁶

3. "[T]he principal amount [will] be due and payable at such times and in such amounts and in such installments as AWCC is required to pay to its respective lender[s] with respect to the amount borrowed by [HAWC]."¹⁷

Applicants represent that: (1) none of the assets of either HAWC or Mauna Lani STP will be pledged as security for the financing arrangement; and (2) HAWC is not expected to incur any expenses in connection with the issuance of the financing arrangement.

3.

Applicants' Requests

At the outset, Applicants represent that: (1) the subject transaction involves the purchase and sale of assets, not stock, thus, HRS § 269-18 does not apply; and (2) because the

¹⁶Exhibit H reflects an interest rate of 4.94 percent and a term of ten (10) years. HAWC, in its response to CA-IR-15(a), confirms that Exhibit H reflects "the most current expected terms for the proposed promissory note."

¹⁷Joint Application, at 19.

transaction does not involve the transfer of stock and since HAWC is a Nevada corporation, HRS § 269-17.5 is also inapplicable.

Applicants request commission action:

1. Approving the Agreement.
2. Approving the sale and transfer to HAWC of Mauna Lani STP's "Transferred Assets," including the CPCN, pursuant to HRS § 269-19.
3. Ordering that Mauna Lani STP's currently approved tariff rules and rates shall continue in effect following closing, and that HAWC shall republish the tariff in its own name with the same rules and rates.
4. Approving or confirming that, following closing, HAWC will have the right to provide utility services to both its existing commission-authorized service territory in the Hawaii Kai area, and Mauna Lani STP's authorized service territory on the island of Hawaii, under their separate, respective tariffs.
5. Approving the issuance of an unsecured promissory note by HAWC in favor of AWCC to fund HAWC's purchase of the "Transferred Assets" from Mauna Lani STP and related closing and transaction costs pursuant to HRS § 269-17.
6. If required, approving HAWC's action of entering into the Financial Services Agreement with AWCC pursuant to HRS § 269-17.

Applicants request commission action approving the Joint Application by March 1, 2006, in anticipation of closing the subject transaction by March 31, 2006.

C.

Consumer Advocate's Proposed Conditions and Recommendations

Applicants served copies of the Joint Application upon the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate"), an *ex officio* party to all commission proceedings.¹⁸

On January 12, 2006, after extensive discovery, the Consumer Advocate submitted its Statement of Position, stating that "sufficient evidence exists to support the Commission's approval of the proposed transaction."¹⁹ Specifically:

1. The proposed sale and transfer should result, at a minimum, in the customers in the Mauna Lani service territory being held harmless. Thus, "[t]he proposed acquisition should not adversely affect customers and appears to be in the public interest."²⁰

2. HAWC is fit, willing, and able to provide wastewater utility service on the island of Hawaii.

3. The terms of the Agreement, in general, appear reasonable.

4. The financing transaction proposed by Applicants to fund the acquisition of Mauna Lani STP should be approved.

¹⁸Applicants and the Consumer Advocate are collectively referred to as the "Parties".

¹⁹Consumer Advocate's Statement of Position and Certificate of Service, filed on January 12, 2006 (collectively, "Statement of Position"), at 6.

²⁰Consumer Advocate's Statement of Position, at 26.

That said, the Consumer Advocate qualifies its conclusions by recommending the adoption of certain conditions, stated verbatim as follows:

1. HAWC should re-file the tariffs for service in the Mauna Lani area to reflect the change in the entity providing service to customers in the area;
2. The Commission should expressly deny any effort to directly or indirectly recover the acquisition premium, transition and/or transactional costs associated with the proposed asset sale. All such costs should be recorded in below-the-line accounts to be amortized and specifically excluded from revenue requirements;
3. HAWC should file a copy of the financial statements that clearly segregate Mauna Lani and Hawaii Kai operations with the Commission and Consumer Advocate. This filing should include a rate of return analysis (that can be provided as an appendix or addendum) that can be easily reconciled with the filed financial statements;
4. HAWC should establish and implement accounting procedures and record keeping processes, especially matters related to allocations of common costs, to ensure that sufficient records exist to facilitate future regulatory review of regulated, non-regulated, and unaffiliated allocated costs;
5. As soon as practical, Applicants should provide agreed upon procedures or arrangements to clearly set forth the manner in which cost allocations between HAWC and MLRO will occur, where applicable, including, but not limited to, the allocation of common area and shared facilities maintenance expenses. In addition, Applicants should initiate procedures that will allow HAWC and MLRO interests to be separately identified, and electricity usage and related billed electricity expenses shall be based on metered usage, rather than relying on estimates to mitigate future cost allocation issues;²¹ and

²¹For Condition No. 5, Part 2, the Consumer Advocate suggests two (2) alternative approaches, including the installation of sub-meters, thereby enabling HAWC to identify the actual electricity consumption of each entity in order to more accurately allocate the common costs, i.e., the "sub-meter

6. If the terms and conditions of the proposed financing transaction significantly change, HAWC should file a notice that informs the Commission and Consumer Advocate of the executed terms and conditions of the financing transaction.

Consumer Advocate's Statement of Position, at 26 - 28.

The Consumer Advocate also offers certain comments for the docket record, as follows:

1. In order to eliminate any possible confusion or misunderstanding in the future about the specific assets Applicants propose to transfer, "the Consumer Advocate recommends that Applicants should agree upon either an amendment or modification to the Agreement to specifically identify the [contributions-in-aid-of-construction] funded assets that will be transferred."²²

2. While acknowledging the national purchasing power of American Water, HAWC should be encouraged to purchase and utilize local resources (labor and non-labor) where practical, feasible, and cost-effective.²³ HAWC, in Applicants' response to CA-SIR-3, confirms its willingness to make such efforts.

3. HAWC intends to rely on its national call center as the first line of interaction with customer inquiries and complaints, with no local presence on the island of Hawaii to

approach." See Consumer Advocate's Statement of Position, Section II(C)(3), at 16 - 18.

²²Consumer Advocate's Statement of Position, Section II(C)(4), at 18 - 19.

²³See Consumer Advocate's Statement of Position, Section II(E)(3), at 22 - 23.

provide customer service functions. While this scenario is a cause for concern, the Consumer Advocate "assumes that HAWC will properly record and maintain records related to complaints received by customers in the Mauna Lani area. If future complaints suggest that future actions are warranted, the Consumer Advocate will investigate those matters at that time."²⁴

4. With anticipated developments in the Mauna Lani service area and project replacements that will necessitate capital improvements in the near future, the Consumer Advocate expresses its general concern that "plant investment decisions might be made when those decisions could be deferred or an alternative might be evaluated to reduce the overall cost of service level."²⁵ That said, "[t]he Consumer Advocate expects information to be provided in the financial statements to be filed that will allow an assessment of these concerns."²⁶

D.

Applicants' Reply

On January 23, 2006, Applicants' filed their Reply to the Consumer Advocate's Statement of Position.²⁷ Applicants do

²⁴Consumer Advocate's Statement of Position, Section II(E)(3), at 24.

²⁵Consumer Advocate's Statement of Position, Section II(E)(4), at 25.

²⁶Consumer Advocate's Statement of Position, at 25.

²⁷Applicants' Statement in Response to the Consumer Advocate's Statement of Position and Additional Request to Clarify Service Territory, Exhibits A and B, and Certificate of Service, filed on January 23, 2006 (collectively, "Reply").

not object to the Consumer Advocate's conditions, finding said conditions reasonable. That said, Applicants state that their non-objection:

. . . is expressly conditioned upon . . . the [Commission's] acceptance of the language of any of such conditions without modification, and the additional clarification and reservations provided by Applicants herein. In the event the Commission elects to adopt any regulatory condition proposed by the Consumer Advocate, but decides to modify the language of such condition, or chooses to impose any additional or separate regulatory conditions, *sua sponte*, Applicants respectfully request the opportunity to pursue any and all of their respective positions through further discussions and/or filings with the Commission and/or the Consumer Advocate.

Applicants' Reply, at 4.

For Condition No. 5, Applicants expand on their non-objection, explaining that:

1. For Part 1, "Applicants are in the process of developing these allocation/cost sharing procedures or arrangements . . . [and] will provide the Commission and Consumer Advocate with a copy of their agreed-upon allocation/cost sharing procedures or arrangements as soon as practical after closing, but in no event later than six months following the closing of the subject transaction."²⁸

2. For Part 2, HAWC will install sub-meters to alleviate any concerns over the possibility of ratepayers subsidizing the resort's usage of electricity.²⁹

²⁸Applicants' Reply, at 5 - 6.

²⁹Applicants represent that the Consumer Advocate does not object to Applicants' sub-meter approach.

In addition, in response to the Consumer Advocate's suggestion to amend or modify the Agreement, Applicants represent that they "will be taking the necessary and appropriate steps to either amend or modify the Agreement to specifically identify the [contributions-in-aid-of-construction] funded assets that will be transferred, or develop some other means that [will] eliminate any confusion or possible misunderstanding about the assets that are being transferred."³⁰

Lastly, Applicants seek to modify its third Prayer for Relief³¹ by replacing Mauna Lani STP's current service area map with a new map (Exhibit B of Applicants' Reply) in order to "resolve [an] apparent ambiguity and to clearly outline the areas of [Mauna Lani STP's] authorized service territory."³²

II.

Discussion

A.

Fitness, Willingness, and Ability to Perform the Wastewater Utility Operations

To determine whether the transfer and sale of Mauna Lani STP's utility assets, operations, and CPCN to HAWC are

³⁰Applicants' Reply, at 8.

³¹See Section I(B)(3), Applicants' Requests, of this Decision and Order.

³²Applicants' Reply, Section II, Request to Clarify [Mauna Lani STP's] Service Territory, at 8 - 9. Applicants: (1) explain that Mauna Lani STP's current service area map is subject to an interpretation that erroneously excludes one of Mauna Lani STP's existing customers, the Resort Administration facility, from the service territory; and (2) represent that the Consumer Advocate does not object to Applicants' Exhibit B.

appropriate, the commission must first examine whether HAWC is fit, willing, and able to operate as a public utility in providing wastewater service for the Mauna Lani service area.

The definition of "public utility" includes "[a]ny person insofar as that person owns or operates a private sewer company or sewer facility[.]" HRS § 269-1(1)(A).

HRS § 269-7.5(a) provides that no public utility shall commence business in the State of Hawaii ("State") without first having obtained a CPCN from the commission. Pursuant to HRS § 269-7.5(b), a CPCN shall be issued if the holder "is fit, willing, and able to properly perform the service proposed and to conform to the terms, conditions, and rules adopted by the commission, and that the proposed service is, or will be, required by the present or future public convenience and necessity."

Applicants represent that HAWC "is or will be sufficiently fit, willing and able to provide [utility] service to Mauna Lani STP's service territory, to satisfy all of its public utility obligations, and to conform to the terms, conditions, rules, and regulations of the Commission, and that the subject transaction is reasonable and in the public interest."³³

Applicants specifically state:

1. HAWC's affiliate, AWCC, will provide the funding to purchase the Transferred Assets.

³³Joint Application, at 10.

2. HAWC "has or will have the financial fitness and ability to fund the continuing operations of the Transferred Assets through the revenue generated from the utility operations . . . it will purchase from Mauna Lani STP[.]"³⁴

3. HAWC's "willingness to assume the responsibilities of owning the Transferred Assets and operating the utility is evident from the considerable time, effort, and energy spent negotiating the Agreement, the significant amount of funds expended and anticipated to be expended in connection with the proposed acquisition, and by its joinder in the filing of this Application requesting regulatory approval of the subject transaction."³⁵

4. HAWC agrees to offer employment to Mauna Lani STP's existing employees, effective as of the closing date of the Agreement, "at no less than the same or substantially similar compensation packages."³⁶ Applicants are unaware of any current Mauna Lani STP employee who has indicated that said employee will not accept or continue employment with HAWC upon the sale of the Transferred Assets.

5. The retention of Mauna Lani STP's employees will promote and ensure the smooth transition of the Transferred Assets to HAWC, and HAWC will gain the benefit of the employees'

³⁴Joint Application, at 11.

³⁵Joint Application, at 11.

³⁶Agreement, Section 8.4. See also Applicants' response to CA-IR-6. Presently, Mauna Lani STP has three (3) full-time employees and one (1) part-time employee. Id.

experience and knowledge in operating Mauna Lani STP's utility system.

6. HAWC and its upstream affiliates have: (A) extensive experience in the water and wastewater industries; and (B) the ability "to provide any necessary support and other services to ensure the successful operation of the acquired utility operations without any degradation of service to Mauna Lani STP's customers."³⁷ In addition, HAWC intends to utilize its existing Hawaii-based management and employees "to provide additional assistance and support to Mauna Lani STP's existing employees to ensure the successful continued operation of the Transferred Assets."³⁸

7. HAWC, with the assistance and experience of its parent and affiliates, has the ability "to successfully own, operate, manage, and maintain the wastewater system currently owned by Mauna Lani STP."³⁹

8. The transition of Mauna Lani STP's Transferred Assets to HAWC "should be relatively seamless. American Water has extensive experience in this area and notably has acquired and successfully and seamlessly integrated over 100 small water and wastewater utilities over the last 10 years."⁴⁰ Nonetheless, to the extent deemed necessary or useful to ensuring the successful and smooth transition in ownership and HAWC's ability

³⁷Joint Application, at 12.

³⁸Joint Application, at 12.

³⁹Joint Application, at 13.

⁴⁰Joint Application, at 14.

to perform the services currently provided by Mauna Lani STP, Applicants will form a transition team for the purpose of preparing and implementing a transition plan that will result in no degradation of service quality and with as minimal interruption to Mauna Lani STP's customers as possible.

9. Upon closing, HAWC commits and agrees to abide by and conform to all applicable commission rules and orders, including all duties and obligations currently imposed on Mauna Lani STP. In addition, HAWC agrees to "assume and abide by all of Mauna Lani STP's rights and obligations under all outstanding permits, contracts and other agreements that will be assigned" to HAWC, pursuant to Sections 1.1 and 1.3 of the Agreement.

The Consumer Advocate states that HAWC is fit, willing, and able to provide wastewater utility service in Mauna Lani STP's service area. In this respect, the Consumer Advocate notes:

1. HAWC, as a subsidiary of RWE, "has access to financial resources that could be made available to fund necessary capital improvements in the Mauna Lani area, and to also provide operating capital, if necessary."⁴¹

2. Based on HAWC's execution of the Agreement, it appears reasonable to conclude that HAWC is willing to provide the existing wastewater utility service.

⁴¹Consumer Advocate's Statement of Position, at 8 (citing to the Joint Application, Exhibit C, HAWC's Audited Financial Statements for the Years Ending December 31, 2004 and December 31, 2003).

3. Upon closing, HAWC will offer continued employment to all of Mauna Lani STP's existing employees. Thus, the wastewater service HAWC intends to provide will be no less than what is currently provided by Mauna Lani STP. Also, Applicants represent that the customers in the Mauna Lani area should benefit from the extensive experience and knowledge offered as a subsidiary of American Water and RWE. Accordingly, "if the proposed transaction is approved by the Commission, there should be sufficient technical and managerial ability to provide quality utility service."⁴²

Based on the foregoing, the commission finds that HAWC is fit, willing, and able to properly perform the wastewater utility service proposed and to conform to the terms, conditions, and rules adopted by the commission, as evidenced by the representations and information in the Joint Application and responses to information requests, including HAWC's access to financial resources to fund necessary capital improvements and provide operating capital, the retention of Mauna Lani STP's employees, and the assistance and experience of HAWC's affiliates and its present experience in providing wastewater utility service in the Hawaii Kai service territory.

B.

Sale and Transfer of Mauna Lani STP's Assets

HRS § 269-19 provides in respective part that "[n]o public utility corporation shall sell, lease, assign, mortgage,

⁴²Consumer Advocate's Statement of Position, at 9.

or otherwise dispose of or encumber the whole or any part of its road, line, plant, system, or other property necessary or useful in the performance of its duties to the public . . . without first having secured from the public utilities commission an order authorizing it so to do. Every such sale, lease, assignment . . . [or] disposition . . . made other than in accordance with the order of the commission shall be void." The purpose of HRS § 269-19 is to safeguard the public interest. In re Honolulu Rapid Transit Co., Ltd., 54 Haw. 402, 409, 507 P.2d 755, 759 (1973).

Applicants seek the commission's approval of: (1) the Agreement; and (2) the sale and transfer of Mauna Lani STP's "Transferred Assets," including its CPCN, to HAWC. Applicants assert that the subject transaction is reasonable and consistent with the public interest.

In support thereto, Applicants state that:

1. HAWC will continue to charge Mauna Lani STP's customers the current commission-approved tariff rates. HAWC "has no current intention to seek a general rate increase for Mauna Lani STP's customers as a result of the Asset Purchase."⁴³

2. Mauna Lani STP's customers will benefit from HAWC's ability to access lower cost financing through its affiliate, AWCC. "As a result, future capital investments

⁴³Joint Application, at 15 (footnote and text therein omitted). See also id. at 2 n.3; Applicants' responses to CA-IR-3(c) and CA-IR-18; and Applicants' Attachment CA-IR-18(a)(2)(Part 1)(Notice to Mauna Lani STP's customers of the proposed sale to HAWC, dated August 17, 2005, and Frequently Asked Questions).

required to maintain wastewater service to Mauna Lani STP's customers should be at a much lower capital cost."⁴⁴

3. HAWC plans to invest approximately \$1.3 million to fund capital improvements to Mauna Lani STP's wastewater system over the next five (5) years, thus providing a tangible benefit to ratepayers.⁴⁵

4. The experience and resources of HAWC, its parent and affiliates, and HAWC's planned capital improvements, will improve the service quality and system reliability of Mauna Lani STP's existing utility operations.⁴⁶ Specifically, HAWC intends to:

⁴⁴Joint Application, at 15.

⁴⁵Applicants state that future capital improvements will include:

. . . the investment of approximately \$200,000 to \$400,000 over the next two years to install injection wells for the disposal of effluent. Currently, the system used by Mauna Lani STP involves the use of the effluent at a plant nursery maintained by Mauna Lani Service, Inc. However, the capacity of the existing system is limited and will not be able to meet the growth of the system expected to occur over the next few years. Unlike Mauna Lani STP, [HAWC] has prior experience in designing, constructing and operating injection wells.

Joint Application, at 15 - 16 n.15. See also Applicants' responses to CA-IR-1(a)(2) and (b)(system capacity additions, installation of additional equipment, and additional plant investments), CA-IR-19 (discussion of the \$1.3 million in capital improvements), and CA-IR-20 (installation of the injection wells); and Applicants' Attachment CA-IR-1(b)(Part 1).

⁴⁶See Applicants' response to CA-IR-1(a)(description of Mauna Lani STP's existing service quality and system reliability benchmarks).

A. Continue to meet or exceed the standards and regulations adopted by the State Department of Health ("DOH") for influent and effluent.

B. Analyze, develop, and implement alternative means of effluent disposal.

C. Maintain its ability to timely respond to service interruptions or accidental spills or discharges.

D. Consolidate Mauna Lani STP's billing functions with American Water's national billing operations.

E. Utilizes its "personnel on Oahu and throughout the United States to deal with customer complaints, billing inquiries and other billing issues that may arise."⁴⁷

5. The transaction will result in certain efficiencies, economies of scale, improvements, and enhanced capabilities that are not achievable under Mauna Lani STP's current operations.⁴⁸ For example:

A. HAWC possesses certain in-house capabilities that are currently outsourced by Mauna Lani STP. As such, it is reasonably likely that: (i) some of the specialized engineering functions that are necessary to install the additional equipment to treat the effluent could be managed or performed in-house by HAWC; and (ii) HAWC's in-house professional engineers can install the additional injection wells more efficiently.

⁴⁷Applicants' response to CA-IR-1(a)(1).

⁴⁸See Joint Application, Section D(5)(e), at 17.

B. HAWC maintains national purchasing contracts with a host of vendors listed in Applicants' Attachment CA-IR-4(a) (Part 2).

While the Consumer Advocate finds that the terms of the Agreement, in general, are reasonable, it recommends the adoption of Conditions No. 1 to No. 5 as part of the commission's approval of the Agreement and the sale and transfer of Mauna Lani STP's "Transferred Assets" to HAWC.

The Consumer Advocate explains the basis for its proposed Conditions No. 1 to No. 5 as follows:

1. Condition No. 1:⁴⁹ In the event the commission approves the Joint Application, HAWC should re-file the tariffs for service in the Mauna Lani area to reflect the change in service provider.

2. Condition No. 2:⁵⁰ This proposed condition is consistent with the commission's past decisions: (A) denying the recovery of any acquisition premium from the utility's ratepayers;⁵¹ and (B) denying the recovery of transaction and transition costs from the utility's ratepayers.⁵²

⁴⁹See Consumer Advocate's Statement of Position, at 7.

⁵⁰See Consumer Advocate's Statement of Position, Section II(C)(1)(a), at 9 - 12; and id., Section II(E)(1), at 20 - 21.

⁵¹The Consumer Advocate cites to In re Kaanapali Water Corp., Docket No. 02-0372, Decision and Order No. 20102, filed on March 27, 2003; In re BHP Hawaii, Inc., Docket No. 97-0035, Decision and Order No. 15899, filed on September 10, 1997; and In re Young Bros., Ltd., Docket Nos. 7398 and 7506 (consolidated), Decision and Order No. 12479, filed on June 30, 1993.

⁵²The Consumer Advocate, as an example, cites to In re BHP Hawaii Inc., Docket No. 97-0035, Decision and Order No. 15899,

3. Condition No. 3:⁵³ In support of Condition No. 3, the Consumer Advocate explains:

. . . . To the extent that the costs incurred to provide service in the Mauna Lani area are lower under HAWC management, the benefits of the lower cost of service should be passed on to ratepayers in a future rate proceeding and not used to recover the acquisition premium or transition/transaction costs. To monitor the actual earnings realized under HAWC ownership, and determine the potential need to adjust the existing rates, the Consumer Advocate recommends that HAWC file copies of its annual financial statements with the Commission and the Consumer Advocate. The statements should be modified to specifically segregate the cost of the Mauna Lani and Hawaii Kai operations to enable the Commission and Consumer Advocate to monitor the operating results of each operation. . . . In addition, the Consumer Advocate recommends that the annual financial statements include a return on rate base statement that can be easily reconciled with the information contained in the annual financial statements. This would facilitate the determination that HAWC is not experiencing returns on its rate base that might exceed the rate that can be justified under the then economic conditions.

Consumer Advocate's Statement of Position, at 12 - 13 (footnotes and text therein omitted).⁵⁴

filed on September 10, 1997. See also In re Citizens Comm. Co., dba The Gas Co., Docket No. 03-0051, Decision and Order No. 20354, filed on July 25, 2003. The commission's policy of denying the recovery of transaction and transition costs from the utility's ratepayers, by implication, includes the policy of not allowing the deferral and recovery of such costs from ratepayers (i.e., indirect recovery).

⁵³See Consumer Advocate's Statement of Position, Section II(C)(1)(b), at 12 - 13.

⁵⁴In effect, the Consumer Advocate, by Condition No. 3: (1) proposes certain modifications to HAWC's annual financial statement; and (2) requests that it be served with a copy of HAWC's annual financial statement, concurrently with the commission.

4. Condition No. 4:⁵⁵ The Consumer Advocate anticipates future issues relating to the allocation of costs between: (A) HAWC and American Water; (B) the Hawaii Kai and Mauna Lani operations; (C) HAWC's regulated and non-regulated operations; and (D) HAWC and unaffiliated entities, such as MLRO. These issues, if not addressed, "may result in certain customer bases inappropriately subsidizing other regulated or non-regulated operations."⁵⁶ In response, the Consumer Advocate proposes Condition No. 4, so that regulators have sufficient documentation and information to determine the appropriateness of HAWC's allocation of costs.

5. Condition No. 5:⁵⁷ While Applicants confirm that Tokyu Corporation's retention of the Excluded Assets will not in any way impair or affect the utility's ability to provide reliable, quality wastewater utility service to the Mauna Lani area, the Consumer Advocate expresses concern "regarding the costs that might be incurred to maintain the land and building that is shared between the utility and the owner of the excluded assets."⁵⁸ In response, the Consumer Advocate proposes Condition No. 5 to ensure that Mauna Lani STP's customers do not subsidize the costs of MLRO's resort operations.

⁵⁵See Consumer Advocate's Statement of Position, Section II(E)(2), at 21 - 22.

⁵⁶Consumer Advocate's Statement of Position, at 21.

⁵⁷See Consumer Advocate's Statement of Position, Section II(C)(2) and (3), at 14 - 18.

⁵⁸Consumer Advocate's Statement of Position, at 15.

Tokyu Corporation has chosen to sell Mauna Lani STP because it is not one of its core businesses. Tokyu Corporation selected HAWC as the purchaser of Mauna Lani STP because, "as the owner of the Mauna Lani Bay Hotel & Bungalows, which is one of Mauna Lani STP's largest customers, Tokyu Corporation was interested in having the ownership and management of the utility taken over by a professional utility operator with a nationwide presence and experience to ensure the continued prosperity of the area and to further enhance the confidence of customers and real estate developers in the area with the quality of utility services provided to the area."⁵⁹

HAWC intends to: (1) own and operate Mauna Lani STP's wastewater utility operations utilizing the same personnel and the existing facilities and related infrastructure; (2) continue to provide uninterrupted service to Mauna Lani STP's customers at the same tariff rates, terms, and conditions of service; and (3) conform to the commission's applicable orders, rules, terms, and conditions of wastewater utility service.

Based on the foregoing, the commission finds that the sale and transfer of Mauna Lani STP's "Transferred Assets" to HAWC is consistent with the public interest, and, as such, will approve the Agreement and the sale and transfer of the "Transferred Assets" to HAWC.

The commission will also adopt as reasonable Conditions No. 1 through No. 5, as agreed-upon by the Parties subject to the

⁵⁹Joint Application, at 5. See also Applicants' response to CA-IR-5.

commission's modification of Condition No. 3. The commission modifies Condition No. 3 by requiring that HAWC: (1) maintain separate books for its Mauna Lani and Hawaii Kai operations; (2) file separate annual financial reports; and (3) separately pay the public utility fees.

For Condition No. 5 and the Consumer Advocate's recommendation to amend or modify the Agreement to specifically identify the contributions-in-aid-of-construction ("CIAC") assets that will be transferred, Applicants shall take the necessary actions consistent with the representations made in their Reply.⁶⁰ In addition, the commission: (1) finds reasonable Applicants' request to replace Mauna Lani STP's current service area map with a new map (Exhibit B of Applicants' Reply); and (2) will allow Applicants' request to take effect upon thirty (30)-day notice from the date of filing of Applicants' Exhibit B (January 23, 2006), consistent with HRS §§ 269-12(b) and 269-16(a) and (b) and HAR § 6-61-111.

C.

Transfer of Mauna Lani STP's CPCN

HRS § 269-19 provides in relevant part that no public utility corporation shall sell, lease, assign or otherwise dispose of any franchise or permit, or any right thereunder, "without first having secured from the public utilities commission an order authorizing it so to do. Every such sale,

⁶⁰See Section I(D), Applicants' Reply, of this Decision and Order.

lease, assignment . . . [or] disposition . . . made other than in accordance with the order of the commission shall be void."

Consistent with Sections II(A) and II(B), above, the commission approves the transfer of Mauna Lani STP's CPCN to HAWC.

D.

Promissory Note and Financial Services Agreement

HRS § 269-17 provides that, upon the commission's prior approval, a public utility corporation may issue stocks and stock certificates, bonds, notes, and other evidences of indebtedness, payable at periods of more than twelve (12) months after the date thereof, for the following purposes, and no other:

for the acquisition of property or for the construction, completion, extension, or improvement of or addition to its facilities or service, or for the discharge or lawful refunding of its obligations or for the reimbursement of moneys actually expended from income or from any other moneys in its treasury not secured by or obtained from the issue of its stocks or stock certificates, or bonds, notes, or other evidences of indebtedness, for any of the aforesaid purposes except maintenance of service, replacements, and substitutions not constituting capital expenditure in cases where the corporation has kept its accounts for such expenditures in such manner as to enable the commission to ascertain the amount of moneys so expended and the purposes for which the expenditures were made, and the sources of the funds in its treasury applied to the expenditures.

HRS § 269-17.

Conversely, "[a] public utility corporation may not issue securities to acquire property or to construct, complete, extend or improve or add to its facilities or service if the commission determines that the proposed purpose will have a

material adverse effect on its public utility operations." HRS § 269-17. "All stock and every stock certificate, and every bond, note, or other evidence of indebtedness of a public utility corporation not payable within twelve months, issued without an order of the commission authorizing the same, then in effect, shall be void." Id.

HRS § 269-7(a) authorizes the commission to examine the condition of every public utility, including all of its financial transactions and its business relations with other persons, companies, and corporations.

Applicants request the commission's approval for HAWC to issue the Promissory Note in favor of AWCC for the purpose of obtaining the necessary funds to pay the purchase price and related closing and transaction costs to consummate the subject transaction. In addition, to the extent the commission determines that its approval is also required for HAWC to enter into the Financial Services Agreement with AWCC, Applicants request such approval.

The Consumer Advocate does not object to the commission's approval of Applicants' proposed financing transaction, finding that "HAWC's intended use of these funds are consistent with the purposes set forth in HRS § 269-17."⁶¹ Concomitantly, the Consumer Advocate recommends the adoption of its proposed Condition No. 6.⁶²

⁶¹Consumer Advocate's Statement of Position, at 19 - 20.

⁶²See Consumer Advocate's Statement of Position, Section II(D), at 19 - 20.

"Purposes 1 and 2 of [HRS § 269-17] contemplate situations where funds for capital acquisition or construction are to be expended after or nearly contemporaneously with the issuance of securities."⁶³

Applicants represent that: (1) the sale will be internally financed by one of American Water's affiliated entity, AWCC; (2) none of the assets of either HAWC or Mauna Lani STP will be pledged as security for the financing arrangement; (3) HAWC is not expected to incur any expenses in connection with the issuance of the financing arrangement; and (4) the transfer of the subject assets from Mauna Lani STP to HAWC should be relatively seamless.

The commission finds that the proceeds from the Promissory Note will be used for the purposes permitted under HRS § 269-17; and (2) there appears no evidence in the docket record that the financing arrangement will have a materially adverse effect on Mauna Lani STP's wastewater utility operations.⁶⁴ Therefore, the commission approves HAWC's financing arrangements with respect to the Promissory Note, consistent with HRS

⁶³In re Citizens Comm. Co., dba The Gas Co., Docket No. 03-0051, Decision and Order No. 20354, filed on July 25, 2003, at 43 (quoting In re Waikoloa Resort Util., Inc., dba West Hawaii Util. Co., Docket No. 98-0090, Decision and Order No. 16340, filed on May 21, 1998, at 5).

⁶⁴HAWC currently utilizes a national call center for its Hawaii Kai wastewater utility operations, and intends to utilize this same service for its Mauna Lani operations. Like the Consumer Advocate, the commission intends to monitor the use of HAWC's national call center for locally generated customer inquiries and complaints. In addition, as suggested by the Consumer Advocate, HAWC shall properly record and maintain records relating to complaints received by its customers in the Mauna Lani service area.

§ 269-17; and by extension, the Financial Services Agreement between HAWC and AWCC, to the extent required under HRS chapter 269 (including HRS § 269-7(a)). In addition, the commission adopts as reasonable Condition No. 6, as agreed-upon by the Parties.

III.

Ultimate Findings of Fact and Conclusions of Law

The commission makes the following ultimate findings of fact and conclusions of law:

1. The six (6) conditions agreed-upon by the Parties, as proposed by the Consumer Advocate and modified by the commission (i.e., Condition No. 3), are reasonable and adopted herein. Likewise, for Condition No. 5 and the Consumer Advocate's recommendation to amend or modify the Agreement to specifically identify the CIAC assets that will be transferred, the commission adopts as reasonable Applicants' efforts to take the necessary actions consistent with the representations made in their Reply. The commission also adopts as reasonable the condition that HAWC properly record and maintain records relating to complaints received by its customers in the Mauna Lani service area.

2. Applicants' request to replace Mauna Lani STP's current service area map with a new map (Exhibit B of Applicants' Reply) is reasonable. Applicants' request will be allowed to take effect upon thirty (30)-day notice, consistent with HRS §§ 269-12(b) and 269-16(a) and (b) and HAR § 6-61-111.

3. HAWC is fit, willing, and able to operate Mauna Lani STP's wastewater utility operations.

4. The sale and transfer of the "Transferred Assets" from Mauna Lani STP to HAWC is consistent with HRS § 269-19 and the public interest.

5. The transfer of Mauna Lani STP's CPCN to HAWC is consistent with HRS § 29-19 and the public interest.

6. The proceeds from the Promissory Note will be used for the purposes permitted under HRS § 269-17, and there appears no evidence in the docket record that the financing arrangement will have a materially adverse effect on Mauna Lani STP's wastewater utility operations.

7. Mauna Lani STP's current commission-authorized tariff is just and reasonable, as previously determined by the commission in In re Mauna Lani STP, Inc., Docket No. 02-0392,⁶⁵ and HAWC's adoption of said tariff, subject to the change noted in Paragraph No. 2 above, is likewise reasonable.

IV.

Orders

THE COMMISSION ORDERS:

1. In accordance with HRS §§ 269-7.5 and 269-19, the sale and transfer of Mauna Lani STP's "Transferred Assets" from Mauna Lani STP to HAWC is approved, subject to the following terms and conditions:

⁶⁵See Decision and Order No. 20405, filed on August 29, 2003; Order No. 20433, filed on September 12, 2003; and Order No. 20594, filed on October 28, 2003.

A. Any effort to directly or indirectly recover the acquisition premium, transition, and/or transactional costs associated with the sale and transfer of the "Transferred Assets" is prohibited and denied. All such costs shall be recorded in "below-the-line" accounts to be amortized and specifically excluded from revenue requirements.

B. HAWC shall maintain separate books for its Mauna Lani and Hawaii Kai operations. It shall file with the commission and also serve upon the Consumer Advocate two (2) separate annual financial reports in accordance with the *Uniform System of Accounts - 1996*, of the National Association of Regulatory Utility Commissioners, covering its wastewater service operations for its Mauna Lani and Hawaii Kai operations, respectively. The reports shall be filed no later than March 31 of each year, for the immediate past calendar year.

HAWC's annual financial reports shall: (i) clearly segregate the Mauna Lani and Hawaii Kai operations; and (ii) include a rate of return analysis, as an appendix or addendum, that can be easily reconciled with the annual financial reports filed by HAWC.

C. HAWC shall establish and implement accounting procedures and record keeping processes, especially matters related to allocations of common costs, to ensure that sufficient records exist to facilitate future regulatory review of regulated, non-regulated, and unaffiliated allocated costs.

D. No later than six (6) months following the closing of the subject transaction, Applicants shall file with

the commission and also serve upon the Consumer Advocate copies of Applicants' agreed-upon procedures or arrangements that clearly set forth the manner in which cost allocations between HAWC and MLRO will occur, including but not limited to the allocation of common area and shared facilities maintenance expenses.

In addition, HAWC shall install sub-meters to alleviate any concerns over the possibility of HAWC's ratepayers subsidizing MLRO's use of electricity.

E. If the terms and conditions of the proposed financing transaction significantly change, HAWC shall file written notice that informs the commission and Consumer Advocate of the executed terms and conditions of the financing transaction. In any event, promptly after closing of the subject transaction, Applicants shall: (i) notify the commission and Consumer Advocate accordingly; and (ii) file with the commission and also serve on the Consumer Advocate executed copies of the Financial Services Agreement (including the executed Promissory Note).

F. Applicants shall take the necessary steps to amend or modify the Agreement to specifically identify the CIAC funded assets that will be transferred, or develop some other means that will eliminate any confusion or possible misunderstanding about the assets that are being transferred. Applicants shall promptly file with the commission and also serve on the Consumer Advocate the amendment or other alternative

utilized that specifically identifies the CIAC funded assets that will be transferred.

G. Promptly after closing of the subject transaction, HAWC shall file with the commission and also serve on the Consumer Advocate its tariff for the Mauna Lani service area, to reflect the change in the entity providing wastewater utility service to the customers in said service area. HAWC's tariff shall include its replacement service area map.

H. Promptly after closing of the subject transaction, HAWC shall provide written notice to its customers of the sale and change in ownership and operation of Mauna Lani STP. HAWC shall provide copies of its written notice to the commission and Consumer Advocate.

I. HAWC shall properly record and maintain records relating to complaints received by its customers in the Mauna Lani service area.

2. The transfer of Mauna Lani STP's CPCN to HAWC is approved, pursuant to HRS §§ 269-7.5 and 269-19.

3. The issuance of the Promissory Note by HAWC in favor of AWCC to fund HAWC's purchase of the "Transferred Assets" from Mauna Lani STP and related closing and transaction costs is approved, pursuant to HRS § 269-17.

4. The Financial Services Agreement between HAWC and AWCC is approved, to the extent required under HRS chapter 269 (including HRS § 269-7(a)).

5. The commission's applicable orders, rules, terms and conditions related to Mauna Lani STP's wastewater utility

operations shall continue in effect, as applied to HAWC, including the annual financial reports (see Ordering Paragraph No. 1(B), above) and public utility fees. HAWC shall separately pay the public fees for its Mauna Lani and Hawaii Kai operations, respectively.

6. The failure to comply with the requirements set forth in Ordering Paragraphs No. 1 and No. 5 above, constitutes cause to void this Decision and Order, and may result in further regulatory action as authorized by law.

DONE at Honolulu, Hawaii FEB 28 2006.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By Carlito P. Caliboso
Carlito P. Caliboso, Chairman

By (EXCUSED)
Wayne H. Kimura, Commissioner

By Janet E. Kawelo
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

Michael Azama
Michael Azama
Commission Counsel

05-0229.cs

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 22299 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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CERTIFICATE OF SERVICE - Continued

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Karen Higashi

DATED: FEB 28 2006